

Pension Fund Committee

Dorset County Council



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| Date of Meeting | 28 February 2018 |
| Officer | Pension Fund Administrator |
| Subject of Report | Treasury Management Strategy 2018-19 |
| Executive Summary | <p>This report revises the previously approved Treasury Management Strategy for 2017-18, approved by the Pension Fund Committee in March 2017.</p> <p>Although the Pension Fund has no strategic allocation to Cash, cashflows need to be managed to ensure there is sufficient liquidity to meet liabilities as they fall due and to invest any surplus balances appropriately. The Treasury Management Strategy (TMS) provides the framework within which officers must manage these cashflows and cash investments.</p> <p>The TMS for the Fund broadly follows the TMS of the County Council, the administering authority for the Fund, where applicable.</p> <p>In relation to counterparty risks and limits, this strategy continues to be consistent with that of the County Council.</p> |
| Impact Assessment: <i>How have the following contributed to the development of this report?*</i> | Equalities Impact Assessment: N/A |
| | Use of Evidence: The use of evidence and information sources to support the Treasury Management Strategy is set out in detail in the main body of this report. |
| | Budget / Risk Assessment: N/A |

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| Recommendation | That the Committee approve the Treasury Management Strategy for 2018-19. |
| Reason for Recommendation | To ensure that the Dorset County Pension Fund manages cashflows and invests surplus cash balances appropriately. |
| Appendices | Appendix 1 Investment Policy Appendix 2 Summary of Investment Criteria |
| Background Papers | |
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Dorset County Pension Fund - Treasury Management Strategy

1. Background

- 1.1 The Pension Fund has no strategic allocation to cash, but it does have a number of cashflows in and out of the fund, including member and employer contributions, pensions and other benefits, dividend and rental income, and investments and disinvestments. The role of treasury management is to ensure that these cashflows are adequately planned so that there is sufficient liquidity to meet liabilities as they fall due, with any surplus monies invested in low risk counterparties, providing adequate liquidity before considering optimising returns.
- 1.2 The Treasury Management Strategy provides the framework within which officers must manage these cashflows and investments, and follows broadly the strategy of the administering authority for the Fund, Dorset County Council, where applicable. The strategy set limits on the amount and length of time that cash can be invested with specific counterparties, to a maximum of two years. This is to reflect the fact that there is not a strategic allocation to cash and investing cash sums for more than this period would be contrary to the Fund's investment strategy.
- 1.3 In relation to counterparty risks and limits, this strategy continues to be consistent with that of the County Council. This report revises the previously approved Treasury Management Strategy for 2017/18, approved by the Pension Fund Committee in March 2017.

2. Treasury Management Advisers

- 2.1 In common with the County Council, the Fund uses Link Asset Services (formerly Capita Asset Services) as its treasury management advisers. Link provides a range of services which include:
- Technical support on treasury matters, capital finance issues and the drafting of reports;
 - Economic and interest rate analysis;
 - Debt services which includes advice on the timing of borrowing;
 - Debt rescheduling advice surrounding the existing portfolio;
 - Generic investment advice on interest rates, timing and investment instruments;
 - Credit ratings-market information service comprising the three main credit rating agencies.
- 2.2 Whilst the advisers provide valuable support to the internal treasury function, the final decision on treasury matters remains with the Fund.

3. Economic Outlook and Prospects for Interest Rates

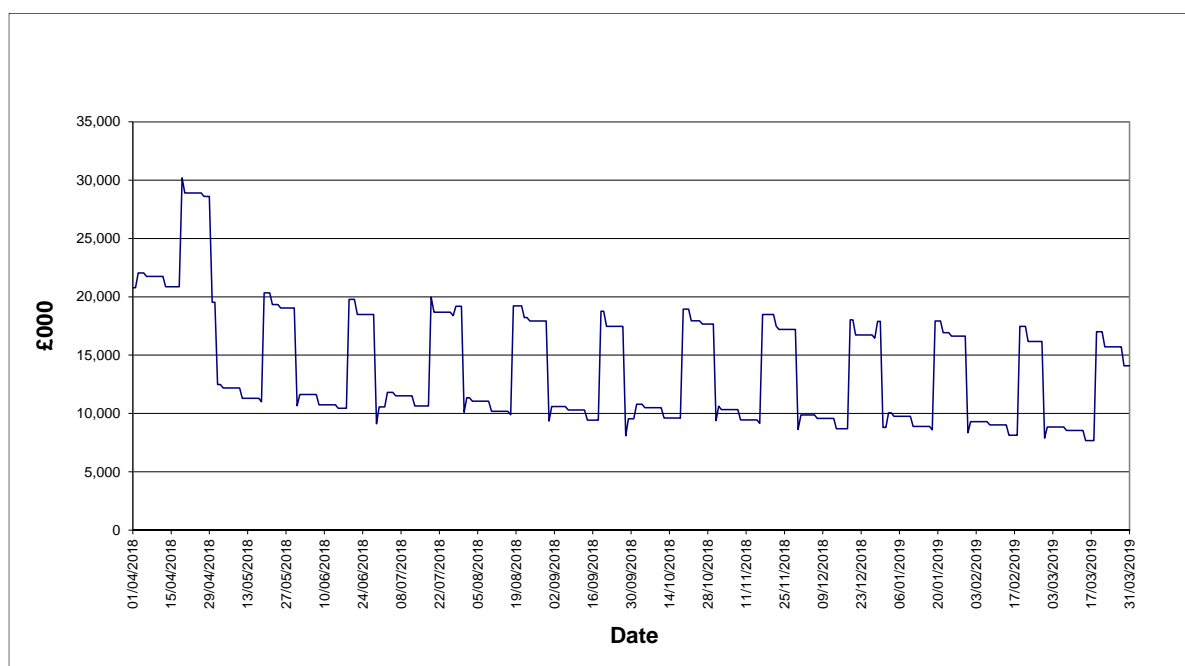
- 3.1 Part of Link's service is assist the Fund to formulate a view on interest rates. The following table shows Link's most recent forecast for UK Bank Rate, short term investment returns (LBID) and borrowing rates from the Public Works Loans Board (PWLb).

| | Now | Dec-17 | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 |
|---------------|------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| BANKRATE | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.25 | 1.25 | 1.25 |
| 3month LIBID | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.60 | 0.60 | 0.60 | 0.70 | 0.90 | 0.90 | 1.00 | 1.20 | 1.20 | 1.20 |
| 6month LIBID | 0.45 | 0.50 | 0.50 | 0.50 | 0.60 | 0.80 | 0.80 | 0.80 | 0.90 | 1.00 | 1.00 | 1.10 | 1.30 | 1.30 | 1.40 |
| 12month LIBID | 0.65 | 0.70 | 0.80 | 0.80 | 0.90 | 1.00 | 1.00 | 1.10 | 1.10 | 1.30 | 1.30 | 1.40 | 1.50 | 1.50 | 1.60 |
| 5Yr PWLB | 1.50 | 1.50 | 1.60 | 1.60 | 1.70 | 1.80 | 1.80 | 1.90 | 1.90 | 2.00 | 2.10 | 2.10 | 2.20 | 2.30 | 2.30 |
| 10 Yr PWLB | 2.10 | 2.10 | 2.20 | 2.30 | 2.40 | 2.40 | 2.50 | 2.60 | 2.60 | 2.70 | 2.70 | 2.80 | 2.90 | 2.90 | 3.00 |
| 25 Yr PWLB | 2.70 | 2.80 | 2.90 | 3.00 | 3.00 | 3.10 | 3.10 | 3.20 | 3.20 | 3.30 | 3.40 | 3.50 | 3.50 | 3.60 | 3.60 |
| 50 Yr PWLB | 2.40 | 2.50 | 2.60 | 2.70 | 2.80 | 2.90 | 2.90 | 3.00 | 3.00 | 3.10 | 3.20 | 3.30 | 3.30 | 3.40 | 3.40 |

3.2 This forecast was produced prior to the Monetary Policy Committee (MPC) meeting 8 February 2018. Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts (and MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact.

4. Cashflow Forecast 2018/19

4.1 The Fund's cash balances will fluctuate throughout the year as income is received and expenditure is made. The chart below shows the projected cashflow forecast for 2018/19 which is based on high level estimates, historic trends and other information. This cashflow forecast is reviewed and updated as necessary on a daily basis through the year.



5. Annual Treasury Management Investment Strategy

5.1. Cash balances are invested on a daily basis using call accounts, pooled money market funds and by making deposits with the Fund's bank, NatWest. Longer term investments can also be made for up to two years but in practice there will be a very heavy bias towards shorter term deposits and investments.

- 5.2. The primary objectives of the Fund's treasury management investment strategy, in order of priority, are:
- the security of funds invested – ensuring that the funds will be repaid by the counterparty to the Fund at the agreed time and with the agreed amount of interest;
 - the liquidity of those funds – ensuring the Fund can readily access funds from the counterparty;
 - the rate of return – ensuring that, given security and liquidity are satisfied, returns are maximised.
- 5.3 The Investment and Creditworthiness Policy of the Fund (see Appendix 1) takes into account the economic outlook and the position of the banking sector in assessing counterparty security risk. In doing so the Fund will ensure:
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed.
 - It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security. This is set out in the Specified and Non-Specified investment sections explained in Annex A of the Investment Policy. Risk of default by an individual borrower is minimised by placing limits on the amount to be lent.
- 5.4 The Policy introduces further measures that are taken to minimise counterparty risk, as a result officers work to:
- a prescribed list of countries that it can invest in;
 - a list of institutions that it can invest with,
 - maximum cash limits that can be invested with these institutions, and
 - restrictions on the length of time investments can be held with these approved institutions.
- 5.5 The counterparty list is maintained by Link who monitor it on a real time basis. The Fund receives a weekly update, but a new list can be distributed at any time if there is any adverse news about any of the institutions on it.

Richard Bates
Pension Fund Administrator
February 2018

APPENDIX 1

Dorset County Pension Fund - Investment and Credit Worthiness Policy

1. Introduction

- 1.1 The cash investment policy of Dorset County Pension Fund (the "Fund") closely follows that of Dorset County Council, who administer the Fund and has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Fund's cash investment priorities will be security first, liquidity second, then return, so that cash resources are safeguarded prior to distribution in line with the Fund's Investment Strategy.
- 1.2 In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Fund has clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the approved lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies. Using the ratings service, provided by Linka Asset Services (formerly Capita Asset Services), the Council's Treasury Management Advisers, potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

2. Cash Investments Policy

- 2.1 The Fund's cash investments policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Fund's cash investments priorities will be security first, liquidity second, then return.
- 2.2 In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Fund applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.
- 2.3 Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Fund will engage with its Treasury Management advisers, Link Asset Services, to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.
- 2.4 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
- 2.5 Investment instruments identified for use in the financial year are listed in Appendix 1 of this Policy under the 'specified' and 'non-specified' investments categories.

Counterparty limits will be as set through the Fund's treasury management practices schedules.

3. Creditworthiness Policy

3.1 The primary principle governing the Fund's cash investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Fund will ensure that:

- It maintains this policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed.

3.2 Risk of default by an individual borrower is minimised by placing limits on the amount to be lent. These limits use, where appropriate, credit ratings from Fitch, Standard and Poors, and Moodys Credit Rating Agencies. All banks and building societies used by the Fund will have a long-term rating of at least A- and a minimum short term rating of F1. Long-term ratings vary from AAA (the highest) down to D the lowest. Short-term ratings vary from F1+ (the highest) down to D. Individual ratings vary from A (the highest) down to E, and these are now being replaced by viability ratings (aaa the highest, to c the lowest) and estimate how likely the bank is to need assistance from third parties. Local authorities are not generally rated. The limits to be used are set out in paragraph 3.5.

3.3 The Pension Fund Administrator will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to the Pension Fund Committee for approval as necessary. These criteria are separate to that which determines which type of investment instrument are either Specified and Non-Specified investments as it provides an overall pool of counterparties considered to be high quality that the Fund may use, rather than defining what types of cash investment instruments are to be used.

3.4 Credit rating information is supplied by the Fund's treasury management advisers on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of a possible longer term change) are provided almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty at the minimum Fund criteria will be suspended from use, with all others being reviewed in light of market conditions.

Security

3.5 The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) are:

i. Sovereign Ratings

3.5.1 The Fund will only lend to counterparties in countries with the highest sovereign Credit Rating of AAA. The maximum that can be deposited with banks in any one sovereign is £30m at any time. The exception to both rules is the United Kingdom.

ii. Counterparties with Good Credit Quality

3.5.2 The Fund will lend to counterparties with the following counterparty ratings:

Table 1 Counterparty Ratings

| Category | Minimum Credit Rating | Limit |
|--|-----------------------|--------------------------|
| Any Local Authority | n/a | £15 Million |
| Banks & Building Societies | Short F1, Long A- | £15 Million |
| Money Market Funds | AAA | £15 Million (individual) |
| Money Market Funds Notice Account | AAA | £10 Million (individual) |
| UK Government including gilts and the Debt Management Account Deposit Facility (DMADF) | n/a | no limit |

3.5.3 Where a counterparty is part of a larger group, it is appropriate to limit the Fund's overall exposure to the group. Individual counterparties within the group will have their own limit, but will be subject to an overall limit for the group. The limit for any one group will be £15m, except in the case of the four major UK banking groups where the limit would be £30m.

iii. Part Nationalised Banking Groups

3.5.4 The Fund will continue to use banking groups whose ratings fall below the criteria specified above if that banking group remains part nationalised, up to a limit of £30m for the group.

iv. Fund's own Banker (NatWest) and Custodian bank (State Street)

3.5.5 The limits for the Fund's own banker and custodian bank are £30m, however, due to occasional short term unexpected cashflows these limits may be breached. For this reason additional flexibility of an additional £1m is allowed to cover such movements, and to minimise the transaction costs involved with moving small sums of money. Over the long term the £30m should be the maximum.

3.5.6 Any breaches of the £30m limit will be reported to the Fund Administrator on a monthly basis.

v. Major UK Banks

3.5.7 The Fund may invest up to £30m with each of the four major UK banking groups, Barclays Bank PLC, HSBC Bank PLC, Lloyds Banking Group PLC, and The Royal Bank of Scotland PLC (which owns the Fund's bank, National Westminster Bank PLC), taking into account the restrictions of group limits and any other limits which apply. These four banking groups were added explicitly to the Treasury Management Strategy with the rationale that in a worst case scenario, all of the Fund's cash could be placed across these four banks.

vi. Use of Additional Information other than Credit Ratings

3.5.8 Additional requirements under the Code of Practice now require the County Council (and therefore the Fund) to supplement credit rating information. Whilst the above

criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches / Outlooks) will be applied to compare the relative security of differing investment counterparties.

Liquidity

- 3.6 Liquidity is defined as an organisation “having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives” (CIPFA Treasury Management Code of Practice).
- 3.7 In addition it is prudent to have rules for the balance of cash investments between short term and longer term deposits to maintain adequate liquidity. They are:
- i. Fixed Term Investments**

A minimum cash balance of £10M must be maintained in call accounts or instant access Money Market Funds. Any amount above this can be invested in fixed term deposits.
 - ii. Call Deposits**

The amount of call deposits (instant access accounts) should be a minimum of £10m to allow for any unforeseen expenditures, up to a maximum of 100%. From time to time, it may be necessary for call deposits to fall below £10M, when this occurs it should be for no more than one working day. The breaches of the £10M limit will be monitored and reported to the Fund Administrator on a monthly basis.
 - iii. Time and Monetary limits applying to Investments**

The time and monetary limits for institutions on the Fund’s Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

Table 3 – Time and Monetary Limits

| | Minimum Long Term and Short Term Counterparty Rating (LCD Approach) | Money Limit | Time Limit |
|---|--|--------------------------|-------------------|
| Any Local Authority | n/a | £15 Million | 2 Years |
| Banks & Building Societies | AA- / F1+ | £15 Million | 2 Years |
| Banks & Building Societies | A - / F1 | £15 Million | 364 Days |
| Major UK Banks* | n/a | £30 Million | 2 Years |
| Money Market Funds | AAA | £15 Million (individual) | Overnight |
| Money Market Funds | AAA | £10 Million (individual) | 7 Day Notice |
| UK Government including gilts and the DMADF | n/a | Unlimited | 6 Months |
| Part Nationalised Banking Groups** | n/a | £30 Million | 2 Years |
| Fund's Own Banker | n/a | £30 Million | 2 Years |
| *Barclays Bank PLC, HSBC Bank PLC, Lloyds Banking Group PLC and The Royal Bank of Scotland PLC. | | | |
| ** Lloyds Banking Group PLC and The Royal Bank of Scotland PLC. | | | |

iv. Longer Term Instruments

The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-Specified investment category. These instruments will only be used where the Fund's liquidity requirements are safeguarded. This will be limited to counterparties rated AA- long term, and F1+ short term. The level of overall investments should influence how long cash can be invested for. For this reason it has been necessary to introduce a sliding scale of limits that depend on the overall size of cash balances. The smaller the size of the overall cash balances the more important it is that the money is kept liquid to meet the day to day cashflows of the organisation. Likewise if cash balances are large, a greater proportion of the funds can be invested for longer time periods. Table 4 sets out the investment limits.

Table 4 Time Limits for Investments over 365 days

| Time Limit | Money Limit invested with Counterparties rated AA- - F1 + and above | |
|--|--|------|
| Projected Annual Balances | % | |
| More than 1 year, no more than 2 years | 100% | £15M |

- 3.8 In the normal course of the Fund's cash flow operations it is expected that both Specified and Non-Specified investments will be utilised for the control of liquidity as both categories allow for short term investments.
- 3.9 A summary of the proposed criteria for investments is shown in Appendix 2, and a list of counterparties as at 11 January 2018 in accordance with these criteria is shown as Appendix 3 to this policy for information.

Investment Policy - Treasury Management Practice 1

Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management

The CLG issued Investment Guidance on April 2010, and this forms the structure of the Fund's policy below. The CLG is currently consulting over revisions to the Guidance and where applicable the Consultation recommendations have been included within this policy. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sector Guidance Notes. This Fund adopted the Code, through the Administering Authority during 2002 and will apply its principles to all investment activity. In accordance with the Code, the Fund Administrator has produced the Fund's treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy, requires approval each year.

Annual Investment Strategy

The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Fund will use. These are high security (i.e. high credit rating, although this is defined by the Fund, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Fund is set out below.

Strategy Guidelines

The main strategy guidelines are contained in the body of the treasury strategy statement (the Investment Strategy).

Specified Investments

These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Fund has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Office, UK Treasury Bills or gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.

3. A local authority, parish council or community council
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency.
5. A body that is considered of a high credit quality (such as a bank or building society). This covers bodies with a minimum short term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies. Within these bodies, and in accordance with the Code, the Fund has set additional criteria to set the time and amount of monies which will be invested in these bodies.

Non-Specified Investments

Non-specified investments are any other type of investment (i.e. not defined as specified above). This would include investments greater than 1 year in duration. It is proposed that counterparties will be restricted to those in the specified category above when investing for more than a year. In total these longer term loans will be limited to £30m of the total investment portfolio and this has been determined with regard to the forecasts of future cash flow.

The Monitoring of Investment Counterparties

The credit rating of counterparties will be monitored regularly. The Fund receives credit rating information (changes, rating watches and rating outlooks) from Capita Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Fund Administrator, and if required new counterparties which meet the criteria will be added to the list.

Summary of Investment Criteria

APPENDIX 2

| Paragraph | Criteria | Minimum Rating | | Maximum Investment and Exceptions |
|---|--|----------------|-------|--|
| | | Long | Short | |
| Sovereign Limit for All Loans | | | | |
| 3.5.1 | AAA Sovereign Rating | n/a | n/a | £30 Million with any one sovereign, UK no limits |
| Notice Money | | | | |
| A minimum of 10% of total investments, up to a maximum of 100% | | | | |
| 3.5.5 | Council's own Banker | n/a | n/a | £30 Million |
| 3.5.2 | Money Market Funds | AAA | | £15 Million individual |
| 3.5.2 | Money Market Fund Notice Account | AAA | n/a | £10 Million individual |
| Fixed Term Investments | | | | |
| Limited to the amount of excess balances for that term less a margin of £10 Million | | | | |
| Up to 6 months | | | | |
| 3.5.2 | UK Government including gilts and DMADF | | | Unlimited |
| Up to 364 Days | | | | |
| 3.5.2 | Any Local Authority | | | £15 Million |
| 3.5.2 | Banks & Building Societies | A- | F1 | £15 Million Note that no more than £15 Million can be invested with banks in the same group where the highest rated counterparty has a minimum of these ratings See 3.5.4, 3.5.5, 3.5.6, 3.5.7 for exceptions |
| 3.5.7 | Four Major UK Banking Groups: Barclays Bank PLC, HSBC Bank PLC, Lloyds Banking Group PLC, The Royal Bank of Scotland PLC (including National Westminster Bank PLC) | N/a | N/a | £30 Million |
| Up to 2 years | | | | |
| 3.5.2 | Major Banks & Building Societies | AA- | F1+ | £15 Million per bank Note that no more than £15 Million can be invested with banks in the same group where the highest rated counterparty has a minimum of these ratings See 3.5.4, 3.5.5, 3.5.6, 3.5.7 for exceptions |
| 3.5.4 | Part Nationalised Banking Groups: Lloyds Banking Group PLC, The Royal Bank of Scotland PLC (including National Westminster Bank PLC) | n/a | n/a | £30 Million |

